

## Renewable Energy - An Inheritance Tax Opportunity?

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### INTRODUCTION

A combination of harder economic conditions for tenants and potentially generous government incentives is pushing more and more landowners to consider renewable energy as a way of diversifying their activities and maximising returns. Few landowners have sufficient experience or knowledge of the development of renewable energy plant and therefore it is most common for them to work with a development partner to carry out the installation and subsequent operation of the business.

Setting out on a renewable energy venture is one that requires careful planning and consideration, both from a tax and legal perspective. However, one important issue that is often overlooked is the potential for mitigating the landowner's inheritance tax exposure. The value of land on which renewable energy installations have been constructed will often be much higher than agricultural land, and can become a significant asset for inheritance tax purposes.

### CURRENT POSITION

Prior to any development, the value of land, including any structures owned on the land, is potentially subject to inheritance tax at 40% on the death of, or gift by, the landowner. However, there are two key reliefs that can apply to mitigate this.

Agricultural Property Relief (APR) may be available if the land is used for agricultural purposes. This is not considered in detail here, besides perhaps noting that APR only applies to relieve the agricultural value of land. Agricultural land which has additional value through development could still therefore be exposed to inheritance tax if no other relief is available.

Business Property Relief (BPR) will be available if the land is used in the landowner's business, with the value for inheritance tax purposes reduced by 100%. There are other conditions to be met but the key one to consider is that HM Revenue & Customs will not accept a claim for BPR if the business in question is "wholly or mainly that of making or holding investments". This therefore prevents most land or property that is let to third parties from qualifying for BPR.

However, a landowner carrying out the business of generating and supplying electricity should be able to claim BPR on the full value, including any development value, of the assets used in their business – and that would include the land on which the business is situated.

The critical question for BPR purposes is whether the landowner is indeed involved in carrying on a business or whether his activities are analogous to that of a landlord, in receipt of rental income. The answer lies in the way in which the agreement between landowner and developer is structured and operated. The landlord will need to take on the commercial risk associated with entering into a business agreement, as opposed to the limited risk of a tenancy agreement. It will also be important

for the landowner to commit their own capital – and, crucially, their own time - to the running of the business.

### STRUCTURING THE AGREEMENT

There is usually a certain degree of flexibility when it comes to structuring a development and operating agreement.

A common approach is for the landowner to enter into a joint venture or a partnership with the developer, usually for a fixed period of time and with an upfront agreement over how capital is contributed and profits shared. The landowner will typically contribute the land and some working capital whilst the developer contributes working capital and professional expertise. The cost of the development and installation is borne by the partnership, as are all subsequent operating costs. The Feed-In Tariffs (FITs) generated will be payable to the partnership and not to either partner directly. When the landowner subsequently extracts profits from the partnership, this will often take the form of a priority draw on profits, as opposed to any form of fixed income. The landowner may also be entitled to use any electricity generated and may sell this on.

There are various other issues which need careful consideration before entering into any agreement. Legal advice will be required to ensure that the landowner's rights are suitably protected. There are tax implications of such an agreement, including potential Stamp Duty Land Tax, the VAT treatment of FITs, and the availability of capital allowances on the installation costs.

Once the agreement has been implemented to reflect the risk and reward which the landowner is committing to, it is then essential that the agreement is properly adhered to.

## ACTIVE INVOLVEMENT

HMRC will not generally provide any form of advance clearance that an individual is actively carrying on a trading business, as opposed to an investment activity. The test will only therefore ever be applied retrospectively. The onus is on the landowner to take as many steps as possible to demonstrate the fact that they have been actively involved in a commercial business. There is no specific list of factors to consider but common points include the following:

If it is viable, ensure that the contracts for development, FITs invoices and all operating costs are in the name of the partnership. This may not be practical for the purposes of the developer but the situation should be avoided whereby the developer meets all costs and is reimbursed by the landowner.

Arrange meetings, at least annually, with the developer to consider the business and review performance and forecasts. These should be documented.

Prepare and submit partnership accounts and tax returns to reflect the income and the costs of the business separately.

Consider registering the business for VAT to recover the VAT incurred on the upfront costs as well as on the ongoing running costs.

- Notify HMRC of the trade and start paying Class 2 National Insurance Contributions.
- Keep a note of time spent on the business.
- The landowner should provide their personal contact details for an emergency contact list and expect to be called to be the first point of contact for an emergency (e.g. a power fault, vandalism).

## ALTERNATIVES

Many landowners will not have the time or capital to commit to active involvement in a renewable energy venture and instead will opt for a simple passive let whereby they receive some form of guaranteed rental income from the developer

who occupies the land. There may, however, still be scope for mitigating inheritance tax.

Recent case law has introduced the concept of looking at the landowner's affairs as a whole for BPR purposes. In certain circumstances it may be possible to claim BPR on an investment asset which is used as part of a wider, predominant, trading business, even if the asset would, if looked at on its own, clearly be held for investment purposes.

A common scenario is likely to be a farm. If, say, solar panels are installed in a field in which sheep are allowed to graze then there may be scope to claim that the land qualifies as part of the business. Similarly, if a substantial amount of the electricity generated is used by the farm then this would further strengthen a claim that the land is a necessary part of the business. It will be important to consider these factors when preparing the agreement with the developer. Another alternative is the use of a company to take advantage of the tax incentives offered by the Enterprise Investment Scheme (EIS). This would require the renewable energy business to be structured through a new company, in which there are other unconnected investors, that would rent the land from the landowner.

## CONCLUSION

Ultimately, many landowners will not be willing either to commit the time to a new business venture or to relinquish the certainty and security of guaranteed rental returns from their land. However, for the landowner who is willing to accept the commercial risk and dedicate their own time and capital to a renewable energy business, then BPR may be available.

Each case is different with no "one size fits all" answer, and professional advice should be sought. With the right combination of a robust, commercial agreement and the careful operation of that agreement with well-documented actions, landowners may have a real opportunity to mitigate their inheritance tax exposure.

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